



## The Chair's Comments

A View from the Chair, Nan  
E. Hannah

Initially, I told the editors of the *Change Order* that I was going to wait until after the December 15 meeting of the Lien and Bond Law Revision Committee to write these comments, then I printed the "Proposed Revisions"



Hannah

and realized that summarizing those in this column would be an impossible task, so I decided to take another tack related to the revision process. Then, after the January 4 "Summit" referenced in this column, I begged the editor of the *Change Order* to permit a last minute edit and update. This column therefore was written mostly back in early-December, with updates added in early-January since I do not have time for a full re-write.

First and foremost, as a section, we should all be incredibly proud of the time and effort the Revision Committee as a whole have put in, but even more so for the amazing work of the Drafting Subcommittee chaired by Ken Fromknecht and comprised of Greg Ahlum, Keith Coltrain, Ken Michael, and Paul Sheridan. Working in the office with Paul, I have some sense of the time these five have

See COMMENTS page 2

## N.C. Court of Appeals Addresses GC Licensing and Lien Law "Lost Profits"

by Douglas P. Jeremiah

The North Carolina Court of Appeals, in **Signature Development, LLC v. Sandler Commercial at Union, L.L.C.**, 2010 WL 4286383 (N.C.App.) ("Signature"), has addressed whether development-related services require a general contractor's license. While the term "construction manager" is not referenced by the court, some would view the development-related services in the case as that provided by a construction manager as agent. The court in **Signature** also analyzed whether lost profits were lienable, although it is questionable whether the claimant was making a claim for lost profits in the first place.

The Plaintiff, Signature Development, LLC ("Signature") entered into a Development Management Agreement ("Agreement") with Defendant Sandler Commercial at Union, L.L.C ("Sandler") for the retail development of Sandler's property in Union County. Signature's compensation was to be through a series of fees, including: (1) Initial Development Fee; (2) Base Development Fee; (3) Leasing Fee; (4) Sales Fee; and (5) Participation Fee. Sandler paid Signature the first four fees, but not the Participation Fee, which Signature estimated to be not less than \$2,338,806.

Signature filed a Claim of Lien on Real Property on Aug. 8, 2008 in the amount of \$2,338,806 and filed suit to enforce the lien on Aug. 12, 2008. The suit also included claims for breach of contract, breach of covenant of good faith and fair dealing,

unjust enrichment, fraud, negligent misrepresentation, and unfair and deceptive trade practices. Sandler filed a 12(b)(6) motion to dismiss, alleging that Signature's complaint revealed that Signature was a "general contractor" under N.C.G.S. Section 87-1 and that Signature did not have a general contractor's license. The trial court partially granted Sandler's motion to dismiss based upon the court's finding that Signature was an unlicensed general contractor. The trial court also struck Signature's claim of lien on real property.

The Court of Appeals analyzed whether Sandler's motion to dismiss was properly granted based on the general contractor licensing law. The Court of Appeals concluded that Signature "was not a general contractor, but rather served as Sandler's agent under a pure project management arrangement." *Id.* at 11.

### General Contractor Licensing for Development-Related Services

The court began its inquiry by looking at the definition of a general contractor under the licensing statute, "any [firm who] undertakes to superintend or manage...for any [firm] that is not licensed as a general contractor...the construction of any building...where the cost is [\$30,000 or more]." *Id.* at 4. While the licensing statute does not expressly prohibit an unlicensed general contractor from bringing a breach of contract

See "LOST PROFITS" page 3

## Inside This Issue:

- 5 Defective Bid Bonds:  
A Landmine for Protests on  
Public Bids in North Carolina

## “Lost Profits” from page 1

action against the owner, the court noted the North Carolina Supreme Court’s decision in **Bryan Builders Supply v. Midyette**, 162 S.E.2d 507 (1968), holding that an unlicensed general contractor cannot recover under the contract or *in quantum meruit* when that contractor is required to be licensed under Section 87-1. *Id.* at 5.

The court then analyzed the degree of control that Signature exercised over the project using the control test first enunciated in **Helms v. Dawkins**, 232 S.E.2d 710 (1977) (“**Helms** control test”). *Id.* The court looked to its earlier unpublished opinion in **Miley v. H.C. Barrett & Assocs.**, 2002 WL 1013593 (N.C.App.) (“**Miley**”), where it considered the contractual terms in determining whether the defendant in that case had acted as a general contractor. In **Miley**, the court found the defendant to have served as a construction manager where the defendant acted as the plaintiff’s agent, did not exercise control over the project’s performance, and assumed no responsibility for cost, schedule, or quality. **Signature** at 6.

The Agreement between Signature and Sandler defined Signature as the “Project Manager” and Signature was to provide “general management, development, construction management, marketing, and leasing coordination services” in connection with Sandler’s retail development. *Id.* Signature’s project management services were “subject to the general direction, control and approval” of Sandler and Signature was to act as Sandler’s “agent in the management, development, marketing and leasing coordination of the Project.” *Id.* at 9. Sandler retained all responsibility for the project’s costs, including Signature’s. While Signature was able to enter into contracts for \$50,000 or less without Sandler’s approval, it did so “on behalf of [Sandler] and all other contracts had to be approved and executed by Sandler.” All contracts “were to be in Sandler’s name, and Sandler was to approve all plans and specifications.” *Id.* Similar to **Miley**, the court found Signature “assumed no responsibilities for costs, timeliness, or quality of the project.” Based on these contractual provisions, the court concluded that the Agreement “unambiguously vested control over the entire Project with Sandler” and that Signature was not a general contractor, but rather “served as Sandler’s agent under a pure project management arrangement.” *Id.*

### Recent Amendments to 21 N.C.A.C. 12.0208

The court, *in dicta*, noted that a recent amendment to the North Carolina Administrative Code, while not applicable to this case, was instructive. The amendment excludes from the definition of general contractors those firms retained by the owner as “a consultant, agent, or advisor to perform development-related functions.” 21 N.C.A.C. 12.0208 (Cum. Supp. Aug. 2010). The amendment sets out the development-related functions including: site planning and design; formulating a development scheme; obtaining zoning approval; tenant selection and negotiation; interfacing and negotiating with the general contractor, design professionals and other development consultants (including: negotiating contracts on the owner’s behalf, assisting with scheduling issues, and ensuring that any disputes between such parties are resolved to the owner’s satisfaction); cost estimating and budgeting; monitoring the progress of development activities performed by others; obtaining governmental incentives and entitlements; and selecting and sequencing sites for development. These exclusions, however, only apply if the owner has retained a licensed general contractor and the use of the development firm will not impair the general contractor’s ability to communicate with the owner. *Id.* The court noted that the amendment was an attempt to formalize the **Helms** control test and “exclude from the general contractor licensing requirements a party who, like Signature, contracts with the owner to perform the ‘development-related functions’ enumerated in the amendment on a project where, as here, the owner retained a licensed general contractor to perform the general contractor role.” **Signature** at 12. Sandler had also retained Matthews Construction, a licensed general contractor, on the project.

While the Court of Appeals would not come out and use the term, its holding could be interpreted to have found that construction managers acting in a pure agency role are not required to be licensed under the general contractors licensing statute. The amendment to 21 N.C.A.C. 12.0208 seems to add a further requirement that another firm with a general contractor’s license be retained by the owner on the project. The court in **Miley** used the terms “construction

manager” and “pure construction management arrangement.” **Miley** at 13. The court in **Signature** referred to **Signature** as “Sandler’s agent under a pure project management arrangement.” **Signature** at 9. Perhaps the court viewed the term “construction manager” as a term of art and was wary of applying any additional meaning to it. The amendment to 21 N.C.A.C. 12.0208 does not make reference to “construction manager” either.

Regardless of the terminology employed by the court, it would seem that the more a firm acts like a construction manager as agent, the less likely the firm will be required to be licensed as a general contractor. The more a firm acts like construction manager at-risk, for instance where the CM enters into contracts with other contractors, not just on behalf of the owner, and exerts “control” over the project, the more likely the general contractor’s licensure will be required. Based on **Miley** and **Signature**, the courts will look carefully at the terms of the contract in determining the need for a general contractor’s license.

The National Association of Office and Industrial Properties (“NAOIP”), an advocacy group for developers, filed an amicus curiae brief in **Signature**. NAOIP, in its brief, advocated for a determination that Signature, acting as a construction manager as agent of Sandler, did not require a general contractor’s license. NAOIP warned the court that a “written opinion that does not consider all implications of this issue could turn real estate development in North Carolina on its head.” **Brief of Amici Curiae NAOIP** at 4. While it is debatable whether real estate development would have been turned on its head, NAOIP may have had genuine concerns of increased cost if developers were required to retain a firm with a general contractor’s license in order to perform development-related services.

### Lien Rights for Development-Related Services

Sandler sought to characterize Signature as a general contractor in order to defeat as many of Signature’s claims as possible, including its breach of contract claim, and attendant claim of lien on real property. The court performed an extensive analysis into whether Signature was required to have a

See “LOST PROFIT” page 4

## “Lost Profit” from page 3

general contractor’s license, and as a result whether Sandler could raise Signature’s lack of licensure as an affirmative defense in its 12(b)(6) motion. The court did not analyze a more fundamental question, which is whether the services Signature provided, regardless of the characterization, were lienable under the mechanic’s lien statute. There exists a real question as to whether Signature’s services, or those of a construction manager as agent, qualify as an improvement to real property under the lien statute. There do not appear to be any lien cases in North Carolina directly on this particular point.

It is at least questionable whether any of the “development-related” services enumerated in 21 N.C.A.C. 12.0208 would be included under the lien statute’s definitions of “improve” or “improvement.” The definition of “improve” includes terms such as build, effect, alter, repair, demolish, excavate, clear, grade, fill, landscape, and construct roads. N.C.G.S. Section 44A-7(1). The definition specifically includes the furnishing of materials for any of such purposes, or to perform any labor upon such improvements. Amendments were made to the lien statute to add professional services furnished by architects, engineers, land surveyors, and landscape architects, and for rental of equipment directly utilized on the real property in making the improvement. *Id.* These amendments were made because it was not clear whether such professional services and rentals qualified as labor or materials under the lien statute. Similarly it is not clear whether a construction manager’s development-related services would qualify as “labor upon such improvements.” Thus, while a court in the future may find that a construction manager as agent is not required to have a general contractor’s license, that same construction manager’s development-related services may not be found to “improve” real property, and as a result that construction manager may not be entitled to a lien on real property.

### Lien Rights for Signature’s “Lost Profits”

The court considered Signature’s claim of lien on real property, but on an entirely different issue. The court analyzed whether Signature was attempting to lien for its lost profit, noting its prior decision in **W. H.**

**Dail Plumbing, Inc. v. Roger Baker & Assocs., Inc.** 338 S.E.2d 135, 137, (“**W. H. Dail Plumbing**”). “[A] lien under [N.C. Gen. Stat. §] 44A-8 attaches only for ‘debts owing for labor done or professional design or surveying services or material furnished’ ... [n]othing is said about lost profit.” **Signature** at 13. Signature’s lien in the amount of \$2,338,806 was for Signature’s unpaid Participation Fee under provision 4(e) of the Agreement, which provided for “payment to Signature of 20% of the “net profits...realized and distributed by [Sandler] from the sale, financing, refinancing and/or operation of the Project[.]” *Id.* The court stated simply that because Section 44A-8 does not attach to property for lost profit, “there was no debt owing under provision 4(e) which would support the claim of lien.” *Id.*

The court’s analysis of lost profits here was at best pithy and at worst misguided – granted the facts and framework provided in **W. H. Dail Plumbing** are not much more instructive. When contractors bid on a job they will typically (but not always) include in their bid an amount to cover their costs as well as a profit. The profit margin may be as low as 5-10% of the total bid amount. If a profit component is included in the bid, the contractor may not realize that profit until the final payment is made. One example of a contractor’s “lost profit” is if a contractor was removed from the job before it completed its work, and would not realize any of its profit without further payment. In this instance, the contractor would wish to be able to lien for that “lost profit.” On the other hand, depending on how the contractor’s schedule of values was structured, the profit could be earned as part of every pay application submitted. In this example, the contractor would be claiming a lien that included profit for work completed. It is likely that the vast majority of claims of lien in North Carolina include some amount of profit for work completed by the claimant. Unfortunately, the opinions in **W.H. Dail Plumbing** and **Signature** do not take the lost profit analysis this deep.

A contractor claiming a lien for lost profit for work not completed does not appear to be what happened in **Signature**. As mentioned earlier, Signature was compensated by Sandler through a series of fees: (1) Initial Development Fee; (2) Base Development

Fee; (3) Leasing Fee; (4) Sales Fee; and (5) Participation Fee. The method by which Signature’s Participation Fee was calculated relied on the net profit realized by Sandler in connection with the Project. This net profit, however, was Sandler’s net profit, and not necessarily Signature’s. Based on the Agreement, Signature was owed a Participation Fee, among other fees, for the services Signature provided for the Project. In fact, the court noted that Signature completed its services under the Agreement. Even if the Participation Fee was to be considered as part of Signature’s profit, if Signature had completed its work, it should be entitled to the profit as part of its fee. Having profit included in a contractor’s fee for services provided is different than claiming “lost profit” for work not completed by the contractor.

### Conclusion

The Court of Appeals did not make a sweeping decision in **Signature** as to whether all developers or construction managers as agents require a general contractor’s license. In reaching its decision, the court looked to the specific terms of the Agreement and the services that Signature was to provide to Sandler. Going forward, it appears that the recent amendments to 21 N.C.A.C. 12.0208 will have an impact on the licensing question. The court missed a good opportunity to clarify its earlier holding in **W. H. Dail Plumbing** and explain what “lost profit” really means. In the meantime, it may be good advice to avoid any reference to profit, earned or lost, in asserting a claim of lien. As profit is normally a part of a contractor’s fee, contractors should be able to lien for profit earned, even if not for profit “lost.”

*Douglas P. Jeremiah is an associate in the Raleigh office of Conner Gwyn Schenck PLLC, a construction law firm with offices in Raleigh and Greensboro. He can be contacted at [djeremiah@cgspllc.com](mailto:djeremiah@cgspllc.com).*